Genesco Inc.

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Annual Report

1978

1978 Genesco Inc. Annual Report

Financial Highlights Years ended July 31	1978	1977
Net sales	**$1,048,351,000**	$1,014,787,000
Operating income—ongoing operations	**19,364,000**	5,146,000
Net earnings (loss)	**14,936,000**	(135,783,000)
Primary earnings (loss) per common share	**$.90**	$(11.12)

Description of Business

Genesco's operations are in the footwear, men's apparel and specialty and variety retailing businesses. Footwear manufactured and imported by the Company is sold to retailers as well as to consumers through retail stores operated by the Company. Its men's apparel operations manufacture and sell to wholesale customers various items of branded and unbranded men's clothing. Its retailing operations consist of specialty stores selling men's and women's clothing and accessories in the medium-to-better price ranges and variety stores selling merchandise at popular prices.

All of Genesco's operations encounter intensive competition from small specialized companies, divisions of diversified corporations and from volume retailers. Genesco also competes with foreign companies, often at a price disadvantage.

Genesco is not dependent upon any single source of supply for any major raw material and considers its available sources to be adequate. Genesco has approximately 36,000 full time employees in the United States and Canada.

Like most companies in consumer related businesses, Genesco experiences seasonal fluctuations in sales and operating income. Historically, the first two quarters of the Company's fiscal year have been the strongest from the standpoint of both sales and operating income.

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John L. Hanigan
Chairman

Report to Stockholders

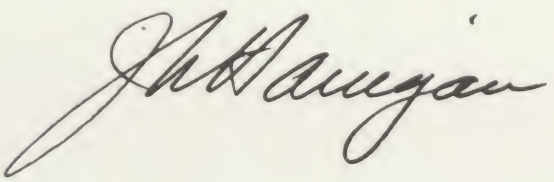
The first phase of the return of your Company to the economic soundness and profitability that you have a right to expect has been largely completed. We continue to believe that the reserves that were set up at the end of fiscal 1977 will be adequate to cover all the contingencies that were foreseen.

The second phase, which will take place over the next few years, will be to reduce the huge load of debt to manageable proportions and to restructure the balance sheet. This will be done by making sure that each of our businesses and each line of products is contributing to earnings as it should.

Some of this phase has already begun. It will not be a pleasant experience for some of us in management because it will mean changing some of the things we are used to doing and, in some cases, the people doing them. The end results will be a smaller but more profitable company.

I am convinced, however, that everyone in the Company is dedicated to the accomplishment of these goals and is working hard to make the right things happen.

While this effort is going on, we will be giving much thought to new directions for the subsequent growth of your Company.



Footwear Sector

In fiscal 1978, the Footwear Sector made an organizational change of major significance. The Canadian footwear operations were merged with U.S. footwear operations. Dan W. Gregory, who headed these operations, has moved to Nashville to serve as deputy general manager of the Footwear Sector.

The cutting edge of the Footwear Sector is retailing. We operate some 1,100 footwear stores and leased departments. These operations are performing extremely well despite some past problems which are discussed later. These stores permit us direct access to the consumer with our own products. Furthermore, they're very profitable, especially where our own products flow through the entire chain of our vertical integration.

"...aggressive retail store expansion (is) planned over the next three years."

Over the years there's been a trend among major footwear companies to dramatically expand their own stores. In the '50s and '60s, Genesco was in the forefront of this development. But in the last several years, we first curtailed and then halted our store opening program. In doing so, we lost ground to our competition.

This situation is now being corrected. In fiscal 1978, we opened 62 new stores. The chart at right shows our aggressive retail store expansion planned over the next three years.

The primary emphasis in our wholesale business is on the development of our own brands. We've carefully targeted our brands to avoid unnecessary overlap and duplication.

Development and advertising programs are scheduled for 1979 to increase awareness of our brands, with special emphasis on Johnston & Murphy, Jarman, and Easy Street.

After the end of the fiscal year, we discontinued our branded children's shoe business, which had not been profitable.

We also serve major chain retailers with private label footwear. We are working on ways to improve our return on assets employed in this area.

In manufacturing, we produce footwear in 17 plants in the U.S. and three in Canada. In addition, we are major users of shoes from Italy, Spain, Brazil, Argentina, Taiwan, Korea, and Mexico.

We are also developing new resources. We have an ongoing program underway with the People's Republic of China which could be of significance for the future. India, the Phillipines, and Hong Kong are also growing in importance, and our programs there, though modest, put us in position to expand these resource bases.

Our Mexican import programs are moving extremely well, and they have a great advantage: they're very close geographically. That's quite helpful in the import business.

Our U.S. plants are located in Tennessee, Mississippi and Kentucky. After the end of fiscal 1978, we closed an older plant in Huntsville, Alabama, a very tight and high priced labor market, and a plant in Carthage, Tennessee. Essentially, our plants are competitive with the domestic industry and technologically above the industry norm.

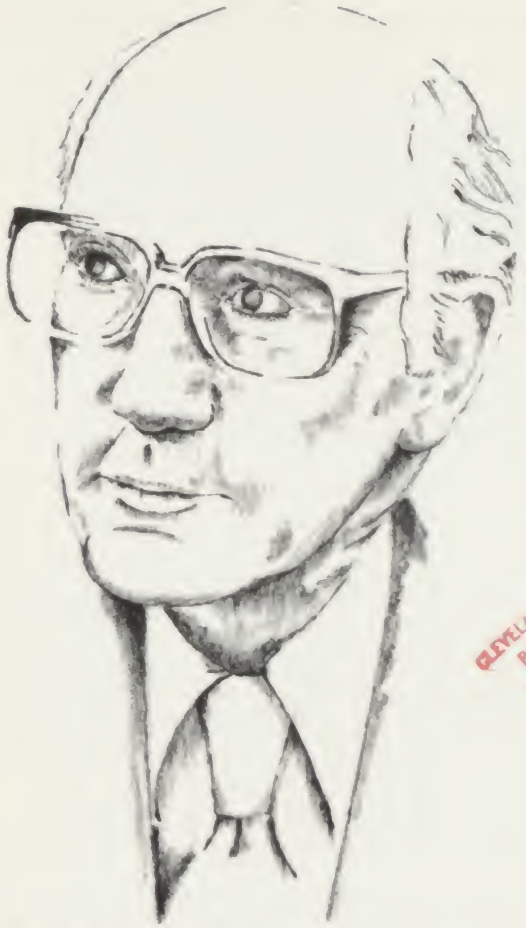
"The primary emphasis in our wholesale business is on the development of our own brands."

Nevertheless, our U.S. and Canadian manufacturing operations continue to be hard pressed by imports. Over 50% of all footwear sold in the U.S. comes from off shore. In Canada the penetration level is now about 55%.

In order to combat this problem, we are placing very strong emphasis on increasing productivity through the application of new technology. The footwear industry as a whole has lagged behind in this area, and we are working on several promising ideas to change this.

Footwear Sector Retail Stores

Fiscal	'78	'79	'80	'81
New Stores Opened or Planned	62	88	111	113
Stores Renovated or to be Renovated	60	87	73	74
Stores Closed or to be Closed	81	22	15	11



George Q. Langstaff, Jr.

Executive Vice President and General Manager of the Footwear Sector.

Mr. Langstaff, 53, has been with Genesco's footwear operations for 30 years. He began his career in 1948, and for the next seven years held a number of manufacturing positions. In 1959 he moved into the footwear marketing area. He was given responsibility for all footwear operations in 1974.

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Several months ago we set up a technology team in footwear to undertake a three-stage evaluation and development program:

First, to look at what technology is now available which we have not fully utilized and to make plans for doing so where appropriate.

Secondly, what technology is under development by someone with whom we might cooperate in order to get an early utilization of that development.

Thirdly, what technology might we develop ourselves on a proprietary basis in order to get a leg up on the competition.

Recently, we've installed two fluid jet cutters which cut synthetic outsoles and insoles with high pressure water at a handsome material savings. This is a first for our industry.

We're now at work with several companies on a computer assisted design concept which, when coupled with the fluid jet or laser cutter, will move from the original design to cut parts without dies or patterns at a great savings in time and labor. This is probably 18 months to two years off.

Process engineering has long been neglected in our industry, but we're correcting that. We will begin to develop a process engineering capability within Footwear which will help us upgrade the efficiency of our plants.

At the same time, we recognize that imports will always play a major role in footwear. Where we are unable to produce competitively in the U.S., we will move aggressively to develop offshore resources. We now import 20% to 25% of our sales. Considering the current degree of import penetration, this percentage will probably increase.

Genesco's Footwear Sector has gone through a number of changes in fiscal 1978, and will continue to do so in order to compete in our changing business environment. We now have underway a major study of the Footwear Sector by the McKinsey Company to help us properly organize and position our footwear operations for the years ahead. The Footwear Sector has been the core of Genesco since its founding and it will continue to be.

Men's Apparel Sector

This sector operates in four major areas: tailored clothing, jeans and casual slacks, underwear and pajamas, and hosiery.

Tailored clothing consists of Phoenix Clothes and Greif and Company. Phoenix, which has consistently produced excellent results, sells suits and sportcoats under the Phoenix and Hardy Amies brands.

Greif has made a dramatic recovery from problems in the early 1970s. Formerly a private label manufacturer, Greif introduced four "Living Label" brands (Lanvin, Chaps by Ralph Lauren, Donald Brooks and Lord Churchill) which now account for a majority of its volume. Just as important, Greif's total sales volume has increased substantially in the last two years.

In spite of very tough market conditions due to inflation, imports and changes in men's lifestyles, there are several positive factors which present opportunities for well managed tailored clothing companies. First, imports appear to have leveled

"We believe that Genesco's tailored clothing business unit is well positioned to capitalize on these opportunities..."

off after rising significantly from 1974 to 1976. Second, demographic trends of age, education, and income all favor a resurgence of traditional apparel. Finally, with so many companies having gone out of business, there is an opportunity for the survivors to increase market share.

We believe that Genesco's tailored clothing business unit is well positioned to capitalize on these opportunities by increasing the importance of its designer and living label brands. The consumer franchise resulting from successful branded programs is our best defense against imports. In addition, it creates the greatest opportunity for satisfactory profit. As one example, beginning with the fall 1979 season, Phoenix will offer products under the label of Oleg Cassini, the internationally known designer.

Larry B. Shelton

Executive Vice President and General Manager of the Men's Apparel Sector. He has 22 years of experience with Genesco.

Mr. Shelton, 44, began his career as an accountant. He held a number of positions in accounting, control and planning before being named chief administrative officer in 1973. In February of 1978 he was named to his current position.

In jeans and slacks, we compete in two markets: private label jeans, slacks and western apparel for the larger chain stores, and fashion jeans and jean-tailored sportswear under the MALE label for specialty and department stores. MALE is a fashion sportswear line and includes a wide range of styles and fabrications.

The jeans and slacks business unit has never produced a satisfactory return on investment. However, many factors now present an opportunity for significant improvement. For example, the increase in 25 to 44 year olds should create a market more in line with MALE products than traditional denim jeans, which appear to be declining in consumer preference. Second, as a result of major improvements during the past two years, Genesco is now positioned to become a major, top quality resource for the chains. In addition, the fashion expertise of MALE can be used in developing additional chain store products. Few chain resources have this product development capability.

The major thrust of Genesco's jeans and slack business over the next three years will be:

To increase penetration of the department store market through branded merchandise programs.

To reduce manufacturing costs through process engineering, mechanization and a reduction of unutilized capacity. We presently have 11 plants, and studies indicate we can operate with about half this number properly engineered and mechanized.

To supplement domestic private label production with products from lower cost resources outside the United States.

To develop a chain of company-owned stores for distributing an appropriate percentage of our products.

"...the increase in 25 to 44 year olds should create a market more in line with MALE products..."

Genesco's underwear and pajama business, which is primarily private label, is currently operating at a loss. This is due mainly to inefficient equipment, excess capacity, and a proliferation of products which are incompatible with manufacturing capability. Our program is to: 1) align the product mix with manufacturing capability; 2) increase volume of profitable specialty products for the screen print trade; 3) capitalize on thermal knitting and dyeing capability to increase market penetration and gross margins of heavyweight underwear; and 4) reduce costs through a program of more efficient utilization of our production facilities.

In hosiery, we sell both branded and private label products to chains, department stores, specialty stores, and mass discounters. Principal brand names are Camp and Dior. This area produces a good return on investment which we plan to improve by increasing our share of the department store market, reducing costs through process engineering, and upgrading equipment. In addition, the hosiery division has an excellent marketing and distribution capability which will be utilized to strengthen the underwear division.

To summarize, Genesco's Men's Apparel Sector has the opportunity to improve its performance by further developing branded products with emphasis on "living labels", increasing penetration of department store markets through emphasis on brands and carefully planned merchandising programs, reducing costs through process engineering and modern machinery, operating company-owned stores selling products made by the company and, finally, reducing working capital tied up in receivables and inventories.

Retail Sector

Genesco's Retail Sector consists of variety, men's specialty, and women's specialty retail operations.

Variety retail includes S. H. Kress & Company and the Commissary stores in Nashville. In fiscal 1978, we merged our V. J. Elmore operation, with 94 stores in the southeastern U.S., into the Kress chain. This was done to take advantage of Kress's superior merchandising expertise and to reduce central overhead. The combined S. H. Kress now operates a total of 234 stores in 25 states.

"In fiscal 1979, Kress plans to open a chain of discount drugstores under the name Post Drugs..."

Kress stores are traditional variety stores, which are under intense competition from mass merchandisers. Rather than continue to compete head on with these operations, Kress is shifting direction. In fiscal 1979, Kress plans to open a chain of discount drugstores under the name Post Drugs, located in shopping centers and carrying only high inventory turn merchandise.

Kress has chosen this route because its buying organization already merchandises all the products carried by such drugstores except prescription drugs. And although there is competition in this market, the existing chains tend to be regional in nature. This leaves opportunities for entry in certain areas. Finally, most companies in this business show a high return on invested capital.

The first Post Drug Stores are planned to open in the spring of 1979. If the concept shows the potential we expect, more will be opened. Meanwhile, we will continue to close unprofitable Kress store locations.

Our men's specialty operations include seven small companies in the eastern U.S. plus the 33-store Roos/Atkins chain on the West Coast. An additional company, Tate-Brown in Charlotte, North Carolina, was sold at the end of fiscal 1978. Generally, the seven companies operate from two to six stores each and in most cases are the dominant men's specialty retailer in the cities where they are located. Baron's, a highly successful operation, has thirteen stores in South Florida and Atlanta. These companies are profitable, although competition from discounters and expanded men's departments in department stores have made maintaining adequate profit margins difficult.

In order to improve results, greater emphasis has been placed on sportswear, and more contemporary merchandise is being offered to attract the younger customer.

In order to maintain market position in these companies, plans call for opening two new stores in fiscal 1979.

Roos/Atkins is slowly recovering from a highly promotional direction set some years ago. It is upgrading its merchandise in order to establish a reputation of quality and credibility.

In order to regain profitability, Roos/Atkins must continue to improve its image, continue to close stores which show little potential, and open new stores in excellent shopping centers. Expansion will be limited only to shopping centers and malls in the greater San Francisco area.

The women's specialty operation includes Bonwit Teller, Henri Bendel, and Plymouth Shops, all headquartered in New York City. Gidding-Jenny,

Ralph H. Bowles

Executive Vice President and General Manager of the Retail Sector, has 18 years of service with Genesco. He joined the company in 1960 after seven years with Sears, Roebuck.

Mr. Bowles, 48, held a series of staff positions before being given responsibility for a number of domestic and international operations in 1973. He was named to head all non-footwear retail operations in 1975.

a single store in Cincinnati, was sold at the end of fiscal 1978.

Bonwit Teller, operating under a tandem management concept, is directing its efforts in two main areas. The first goal is to improve the performance of the 12 stores outside New York City. In the past, too much emphasis was placed on the Fifth Avenue flagship store. By customizing merchandise for each location and in all departments within each store, considerable improvement in volume is expected.

Second, Bonwit is adjusting its fashion merchandising image. In the recent past, Bonwit did not place enough emphasis on being a fashion leader in moderate and better priced merchandise. This has now been corrected.

No store closings are contemplated, but no new stores will be opened until the present ones produce optimum results.

Henri Bendel, located in New York City, had its fifth straight record year in 1978. Its track record is good, and it has the creative and professional merchandising to stay ahead of its competition. There are no plans to open any additional Bendel stores due to the unique nature of the operation.

"Plymouth Shops...will open additional stores whenever good locations become available."

Plymouth Shops is an excellent, well-managed operation. It currently has 32 stores in the greater New York area, and will open additional stores whenever good locations become available.

In summary, the Retail Sector of Genesco is profitable, but is far from the optimum level. The three largest companies in the sector—Bonwit Teller, Roos/Atkins, and S. H. Kress—are restructuring, retrenching, or moving in a different direction. These actions are expected to improve profitability in the future, but it will not reach an optimum level for several years.

1978 Business Segment Information

	In Thousands	1978	1977	1976	1975	1974
Sales to Unaffiliated Customers:	Footwear:					
	Shoes and accessories	**$ 354,571**	$ 313,157	$ 338,260	$ 308,392	$ 312,455
	Raw materials	**66,943**	76,150	78,318	74,696	70,599
	Total footwear	**421,514**	389,307	416,578	383,088	383,054
	Men's apparel:					
	Tailored clothing	**98,025**	82,639	75,726	79,244	94,580
	Jeans and slacks	**80,245**	71,203	79,751	67,646	71,108
	Hosiery	**22,394**	16,456	16,355	14,535	16,363
	Underwear and pajamas	**26,916**	27,497	19,989	23,320	22,804
	Total men's apparel	**227,580**	197,795	191,821	184,745	204,855
	Retailing:					
	Specialty	**243,473**	231,008	217,030	202,969	216,337
	Variety	**155,784**	155,716	164,592	162,074	154,796
	Total retailing	**399,257**	386,724	381,622	365,043	371,133
	Operations to be divested	**—0—**	40,961	71,369	81,922	97,730
	Totals	**$1,048,351**	$1,014,787	$1,061,390	$1,014,798	$1,056,772
Operating Income (loss):	Footwear	**$ 28,772**	$ 17,405	$ 49,131	$ 38,703	$ 37,812
	Men's apparel	**11,441**	5,609	7,667	676	13,581
	Retailing:					
	Specialty	**6,728**	7,732	8,641	5,102	9,964
	Variety	**7,424**	6,668	9,738	6,300	6,396
	Total retailing	**14,152**	14,400	18,379	11,402	16,360
	Corporate expenses	**(13,715)**	(13,622)	(15,952)	(16,875)	(14,765)
	Interest expense	**(21,286)**	(18,646)	(17,787)	(24,951)	(22,351)
	Operating income-ongoing operations	**19,364**	5,146	41,438	8,955	30,637
	Operations to be divested	**—0—**	(6,963)	(187)	(3,276)	(240)
	Totals	**$ 19,364**	$ (1,817)	$ 41,251	$ 5,679	$ 30,397
Assets:	Footwear	**$ 128,748**	$ 114,193	$ 117,591	$ 109,238	$ 111,384
	Men's apparel	**92,039**	85,780	85,995	83,493	102,544
	Retailing:					
	Specialty	**64,155**	69,043	58,333	67,179	78,383
	Variety	**58,303**	53,901	62,333	60,428	70,924
	Total retailing	**122,458**	122,944	120,666	127,607	149,307
	Corporate	**42,780**	70,505	79,311	89,123	81,303
	Operations being divested	**40,928**	63,491	86,082	91,615	114,173
	Totals	**$ 426,953**	$ 456,913	$ 489,645	$ 501,076	$ 558,711
Intersegment Sales (not included above):	Footwear	**$ 566**	$ 845	$ 1,294	$ 1,071	$ 1,485
	Men's apparel	**6,397**	7,531	6,147	5,837	7,688
	Operations to be divested	**—0—**	1,945	1,425	1,783	1,667
	Totals	**$ 6,963**	$ 10,321	$ 8,866	$ 8,691	$ 10,840

Independent Accountants' Report

Price Waterhouse & Co.

THIRD NATIONAL BANK BUILDING
NASHVILLE TENNESSEE 37219
615-244-5050

August 28, 1978

To the Board of Directors and
Stockholders of Genesco Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of earnings, of additional paid-in capital, of deficit and of changes in financial position present fairly the financial position of Genesco Inc. and its subsidiaries at July 31, 1978 and 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse & Co.

Consolidated Balance Sheet

July 31	1978	1977
Assets		
CURRENT ASSETS		
Cash	**$ 20,576,000**	$ 51,435,000
Receivables (Note 3)	**27,574,000**	23,106,000
Inventories (Note 4)	**213,471,000**	199,031,000
Prepaid expenses	**2,064,000**	2,533,000
Current assets of operations being divested (Note 5)	**30,734,000**	51,561,000
Total Current Assets	**294,419,000**	327,666,000
Investments and long-term receivables (Note 6)	**14,339,000**	10,021,000
Plant, equipment and capitalized lease rights (Note 7)	**102,451,000**	101,169,000
Deferred note expense	**1,435,000**	1,765,000
Investment in excess of equity of acquired companies	**4,115,000**	4,362,000
Fixed assets of operations being divested (Note 8)	**10,194,000**	11,930,000
Total Assets	**$426,953,000**	$456,913,000

Liabilities and Stockholders' Equity	1978	1977
CURRENT LIABILITIES		
Notes payable (Note 9)	**$ 61,850,000**	$ 81,450,000
Current payments on long-term debt	**8,447,000**	8,596,000
Current payments on capitalized lease obligations	**8,068,000**	8,793,000
Accounts payable and accrued liabilities	**87,035,000**	76,409,000
Provision for operations being divested (Note 2)	**21,678,000**	37,078,000
Total Current Liabilities	**187,078,000**	212,326,000
Long-term debt (Note 10)	**89,427,000**	97,827,000
Capitalized lease obligations (Note 11)	**37,235,000**	45,788,000
Provision for operations being divested (Note 2)	**24,567,000**	27,519,000
Deferred credits to income	**4,542,000**	4,803,000
Stockholders' equity (Note 12):		
Preferred stock	**100,429,000**	101,689,000
Common stock	**13,100,000**	13,030,000
Additional paid-in capital	**60,849,000**	59,588,000
Deficit	**(42,647,000)**	(57,583,000)
Treasury stock, at cost	**(28,681,000)**	(28,678,000)
Employee stock purchase accounts	**(18,946,000)**	(19,396,000)
Total Stockholders' Equity	**84,104,000**	68,650,000
Total Liabilities and Stockholders' Equity	**$426,953,000**	$456,913,000

Consolidated Additional Paid-In Capital

Years ended July 31	1978	1977
Balance at beginning of year	**$ 59,588,000**	$ 58,542,000
Conversion of preferred stock	**1,516,000**	1,380,000
Sales price in excess of par value of common shares issued	**72,000**	—0—
Expenses relating to capital stock issuances	**(32,000)**	(39,000)
Increase in liquidating value of preferred stocks	**(295,000)**	(295,000)
Balance at End of Year	**$ 60,849,000**	$ 59,588,000

The accompanying Notes are an integral part of these Financial Statements.

Consolidated Earnings Statement

Years ended July 31	1978	1977
Net sales	**$1,048,351,000**	$1,014,787,000
Cost of sales	**705,740,000**	693,085,000
Gross margin	**342,611,000**	321,702,000
Selling, general and administrative expenses	**302,960,000**	304,500,000
Interest expense	**21,286,000**	18,646,000
Other income (expense)	**999,000**	(373,000)
Operating income (loss):		
Ongoing operations	**19,364,000**	5,146,000
Operations to be divested	**—0—**	(6,963,000)
Total operating income (loss)	**19,364,000**	(1,817,000)
Provision for divestments and retail store closings (Note 2)	**—0—**	(33,224,000)
Pretax earnings (loss)	**19,364,000**	(35,041,000)
Income taxes (Note 13)	**10,017,000**	45,287,000
Nonconsolidated companies	**(285,000)**	(262,000)
Earnings (loss) before discontinued operations and extraordinary credit	**9,062,000**	(80,590,000)
Discontinued operations (Note 2):		
Operating loss	**—0—**	(11,857,000)
Provision for future losses	**—0—**	(43,336,000)
Earnings (loss) before extraordinary credit	**9,062,000**	(135,783,000)
Extraordinary credit—U.S. Federal income tax (Note 13)	**5,874,000**	—0—
Net Earnings (Loss)	**$ 14,936,000**	$ (135,783,000)
Earnings (loss) per common share:		
Primary:		
Before discontinued operations and extraordinary credit	**$.44**	$ (6.71)
Before extraordinary credit	**$.44**	$(11.12)
Net earnings (loss)	**$.90**	$(11.12)
Fully diluted:		
Before discontinued operations and extraordinary credit	**$.41**	$ (6.71)
Before extraordinary credit	**$.41**	$(11.12)
Net earnings (loss)	**$.84**	$(11.12)

Consolidated Deficit

Years ended July 31	1978	1977
Balance at beginning of year	**$ (57,583,000)**	$ 78,263,000
Net earnings (loss)	**14,936,000**	(135,783,000)
Preferred dividends paid	**—0—**	(61,000)
Redemption of preferred stock	**—0—**	(2,000)
Balance at End of Year	**$ (42,647,000)**	$ (57,583,000)

The accompanying Notes are an integral part of these Financial Statements.

Consolidated Changes in Financial Position

Years ended July 31	1978	1977
Sources of Working Capital		
Earnings (loss) before discontinued operations	**$ 9,062,000**	$(80,590,000)
Extraordinary credit—U.S. Federal income tax	**5,874,000**	—0—
Depreciation and amortization	**15,031,000**	15,577,000
Equity in nonconsolidated companies:		
Genesco Financial Corporation	**(2,711,000)**	(2,322,000)
Other nonconsolidated companies	**285,000**	262,000
Write-off of noncurrent future tax benefits	**—0—**	25,645,000
Write-off of excess of cost over equity	**—0—**	4,043,000
Write-down of fixed assets of companies to be divested	**—0—**	4,921,000
Write-off of deferred credits to income	**—0—**	(1,277,000)
Increase in noncurrent provision for operations being divested	**—0—**	8,385,000
Other charges to earnings not requiring funds	**324,000**	3,133,000
Working capital provided by (used by) operations before discontinued operations	**27,865,000**	(22,223,000)
Discontinued operations:		
Net operating loss		(11,857,000)
Provision for future losses		(43,336,000)
Depreciation and amortization		2,268,000
Write-off of excess of cost over equity		3,267,000
Write-down of fixed assets		9,901,000
Write-off of deferred credits to income		(1,554,000)
Increase in noncurrent provision for operations being divested		9,025,000
Other credits to earnings not requiring funds		(33,000)
Working capital used by discontinued operations	**—0—**	(32,319,000)
Working capital provided by (used by) operations	**27,865,000**	(54,542,000)
Plant and equipment sales	**3,618,000**	2,859,000
Additions to capitalized lease obligations	**1,689,000**	7,711,000
Other changes in investments and long-term receivables	**(2,059,000)**	2,933,000
Other sources of working capital	**1,191,000**	2,134,000
Totals	**$32,304,000**	$(38,905,000)

The accompanying Notes are an integral part of these Financial Statements.

Years ended July 31	1978	1977
Uses of Working Capital		
Long-term debt paid or charged against working capital	**$ 8,449,000**	$ 8,602,000
Reduction in capitalized lease obligations	**10,242,000**	9,678,000
Items affecting provision for operations being divested	**3,888,000**	3,289,000
Additions to plant, equipment and capitalized lease rights	**17,724,000**	17,391,000
Preferred dividends paid	**–0–**	61,000
Redemptions of preferred stock	**–0–**	100,000
Totals	**40,303,000**	39,121,000
Decrease in Working Capital	**$ (7,999,000)**	$(78,026,000)

Increase (Decrease) in Components of Working Capital	**1978**	1977
Cash	**$(30,859,000)**	$ 35,834,000
Receivables	**4,468,000**	(5,624,000)
Inventories	**14,440,000**	(44,632,000)
Prepaid expenses	**(469,000)**	1,897,000
Future tax benefits	**–0–**	(16,000,000)
Current assets of operations being divested	**(20,827,000)**	51,561,000
Total current assets	**(33,247,000)**	23,036,000
Notes payable	**(19,600,000)**	81,450,000
Current payments on long-term debt	**(149,000)**	(1,383,000)
Current payments on capitalized lease obligations	**(725,000)**	(562,000)
Accounts payable and accrued liabilities	**10,626,000**	(13,081,000)
Provision for operations being divested	**(15,400,000)**	34,638,000
Total current liabilities	**(25,248,000)**	101,062,000
Decrease in Working Capital	**$ (7,999,000)**	$(78,026,000)

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The accompanying Notes are an integral part of these Financial Statements.

Note 1 Summary of Accounting Policies

Basis of Consolidation
The consolidated financial statements include the accounts of the Company and all domestic and Canadian subsidiaries, except Genesco Financial Corporation (GFC). Nonconsolidated subsidiaries are carried at cost adjusted for undistributed earnings or losses since acquisition. Income before taxes of GFC is included in the consolidated earnings statement as a reduction of interest expense with the related income tax included in income taxes. The combined results of all other nonconsolidated subsidiaries are included as a single item in the consolidated earnings statement.

Inventories
Inventories are stated at the lower of approximate average cost or market determined, in wholesaling and manufacturing companies, principally on the first-in, first-out method. Inventories of retail companies are determined by the retail method.

Plant, Equipment and Capitalized Lease Rights
Plant, equipment and capitalized lease rights are depreciated or amortized over the estimated useful life of the related assets. Depreciation and amortization expense is computed principally by the straight-line method.

Amortization of Intangibles
The excess of cost over equity of purchased companies reflected in the consolidated financial statements is being amortized over a forty-year period. Gains from the sale and leaseback of plant and equipment are being amortized over the lives of the respective leases.

Retirement Plans
Substantially all of the Company's employees are covered by pension plans. The Company funds pension costs accrued as determined by its independent actuaries.

Earnings per Common Share
Primary earnings per share are computed by dividing net earnings (loss), adjusted for preferred dividend requirements, by average common shares and common share equivalents outstanding. In computing fully diluted earnings per share, earnings and average shares are appropriately adjusted for outstanding dilutive securities.

Foreign Currency Translation
Current assets (excluding inventories) and liabilities of foreign subsidiaries are translated into U. S. dollars at exchange rates in effect at the balance sheet date. Inventories and noncurrent assets are translated at historical exchange rates. Income, costs and expenses are translated at average rates during the year except that historical rates are used to translate depreciation and cost of sales. Aggregate exchange losses for 1978 and 1977 amounted to $274,000 and $1,154,000, respectively.

Note 2 Operations to be Divested and Retail Store Closings

On August 31, 1977, the Company's Board of Directors approved a plan for divestment of the Company's sixteen operating divisions which made up its Women's and Children's apparel segment and of six divisions in other areas. The plan contemplated sale of the majority of the divisions; however, some were identified to be phased out if not sold as ongoing businesses. The total provision required to cover the costs expected to be incurred in carrying out the plan was made up of individual provisions based on a specific plan for each of the twenty-two operating divisions slated for divestment. The individual provisions ranged from $100,000 to $8,000,000. All of the action called for in the plan was expected to be completed during fiscal 1978; however, ten operations were not divested in fiscal 1978 but are expected to be divested in fiscal 1979. Management believes the remaining provision is reasonable and actual costs incurred in carrying out the plan should not be significantly different from amounts provided in 1977. There are certain long-term commitments which are expected to continue into future periods for which provisions are classified as long-term liabilities in the consolidated balance sheet.

The total provision for divestments and retail store closings of $76,560,000 set up in 1977 included:

	Provision for Divestments		Provision for Retail Store Closings	Total
	Women's and Children's	Other		
Write-off of investment in excess of equity	$ 3,267,000	$ 4,043,000	$ —0—	$ 7,310,000
Provision for future losses	30,736,000	12,356,000	6,819,000	49,911,000
Provision for disposal of assets	9,333,000	4,435,000	5,571,000	19,339,000
Totals	$43,336,000	$20,834,000	$12,390,000	$76,560,000

Operating results for 1977 of the discontinued Women's and Children's segment were net sales of $172,074,000 and a net loss of $11,857,000.

At the beginning of fiscal 1977, the balances in the provision for operations being divested accounts were applicable to lease obligations of retail stores closed as a result of a 1973 program to restructure the Kress variety store chain and other retail operations. A summary of the activity in these accounts is as follows:

	1978	1977
Balance at beginning of year	**$64,597,000**	$15,818,000
Provision for divestments and retail store closings	**—0—**	52,742,000
Operating losses:		
Women's and Children's (1978 sales—$117,690,000)	**(6,366,000)**	—0—
Other	**(3,232,000)**	—0—
Other costs	**(8,754,000)**	(3,963,000)
Balance at End of Year	**$46,245,000**	$64,597,000

Proceeds from divestment of Women's and Children's operations amounted to $11,927,000 in 1978.

Note 3 Receivables

Genesco sells most of its accounts receivable to Genesco Financial Corporation (GFC) at the outstanding balance less a 10% reserve for uncollectible accounts. The receivable amounts in the consolidated balance sheet are net of amounts financed with GFC.

	1978	1977
Trade accounts receivable	**$144,918,000**	$ 123,775,000
Miscellaneous receivables	**3,329,000**	2,912,000
Total receivables	**148,247,000**	126,687,000
Allowance for bad debts	**(4,251,000)**	(4,532,000)
Allowance for cash discounts and returns	**(955,000)**	(644,000)
Net receivables before financing	**143,041,000**	121,511,000
Sold to GFC	**(115,467,000)**	(98,405,000)
Net Receivables	**$ 27,574,000**	$ 23,106,000

Note 4 Inventories

	1978	1977
Raw materials	**$ 23,534,000**	$ 33,787,000
Work in process	**23,395,000**	23,014,000
Finished goods	**49,771,000**	36,235,000
Retail merchandise	**116,771,000**	105,995,000
Total Inventories	**$213,471,000**	$199,031,000

Note 5 Current Assets of Operations Being Divested

	1978	1977
Accounts receivable, net of allowance for bad debts and cash discounts	**$ 14,516,000**	$ 30,531,000
Sold to GFC	**(11,378,000)**	(24,178,000)
Net accounts receivable	**3,138,000**	6,353,000
Inventories	**27,596,000**	45,208,000
Total Current Assets of Operations Being Divested	**$ 30,734,000**	$ 51,561,000

Note 6 Investments and Long-Term Receivables

	1978	1977
Equity in Genesco Financial Corporation (GFC)	**$ 28,502,000**	$ 25,791,000
Less advance by GFC to Trustee of Genesco employee stock plans	**16,000,000**	16,000,000
Net equity in GFC	**12,502,000**	9,791,000
Investments and advances:		
Nonconsolidated subsidiaries	**237,000**	(1,426,000)
Other investments and long-term receivables	**1,600,000**	1,656,000
Totals	**$ 14,339,000**	$ 10,021,000

Investments in nonconsolidated subsidiaries include an investment of $20,177,000 in Charles Jourdan and affiliated companies, manufacturers and retailers of women's fashion footwear based in France. The Company is attempting to sell this operation. Net proceeds from any sale would be used to pay certain obligations of nonconsolidated subsidiaries with the remaining proceeds being used to prepay short-term indebtedness of the Company under its revolving credit agreement. See Note 9 "Short-Term Borrowing Arrangements."

The condensed consolidated balance sheet of Genesco Financial Corporation and Subsidiary at July 31, 1978 and 1977 follows:

Assets	**1978**	1977
Cash	**$ 1,490,000**	$ 15,816,000
Accounts receivable purchased from Genesco less contract reserve withheld	**126,845,000**	122,583,000
Notes receivable-Trustee of Genesco employee stock plans	**16,000,000**	16,000,000
Notes receivable-other	**258,000**	397,000
Prepaid interest	**—0—**	291,000
Deferred note expense	**422,000**	489,000
Total Assets	**$145,015,000**	$155,576,000

Liabilities and Stockholder's Equity	**1978**	1977
Notes payable to banks	**$ 34,000,000**	$ 47,750,000
Accrued liabilities	**2,513,000**	2,035,000
Long-term debt	**80,000,000**	80,000,000
Stockholder's equity	**28,502,000**	25,791,000
Total Liabilities and Stockholder's Equity	**$145,015,000**	$155,576,000

Note 7
Plant, Equipment and Capitalized Lease Rights

	1978	1977
Plant and equipment:		
Land	**$ 1,098,000**	$ 1,125,000
Buildings and building equipment	**8,121,000**	7,392,000
Machinery, furniture and fixtures	**69,786,000**	71,725,000
Construction in process	**3,737,000**	1,883,000
Improvements to leased property	**46,052,000**	46,315,000
Capitalized lease rights:		
Land	**2,408,000**	2,470,000
Buildings	**44,296,000**	46,656,000
Machinery, furniture and fixtures	**45,703,000**	51,942,000
Total plant, equipment and capitalized lease rights	**221,201,000**	229,508,000
Accumulated depreciation and amortization:		
Plant and equipment	**(77,399,000)**	(87,159,000)
Capitalized lease rights	**(41,351,000)**	(41,180,000)
Totals	**$102,451,000**	$ 101,169,000

Note 8 Fixed Assets of Operations Being Divested

	1978	1977
Plant and equipment:		
Land	**$ 138,000**	$ 237,000
Buildings and building equipment	**1,382,000**	1,679,000
Machinery, furniture and fixtures	**5,063,000**	24,980,000
Construction in process	**19,000**	15,000
Improvements to leased property	**3,367,000**	5,596,000
Capitalized lease rights:		
Land	**1,576,000**	1,551,000
Buildings	**11,681,000**	13,399,000
Machinery, furniture and fixtures	**732,000**	3,765,000
Total fixed assets of operations being divested	**23,958,000**	51,222,000
Accumulated depreciation and amortization:		
Plant and equipment	**(9,804,000)**	(34,059,000)
Capitalized lease rights	**(3,960,000)**	(5,233,000)
Totals	**$10,194,000**	$ 11,930,000

Note 9 Short-Term Borrowing Arrangements

At July 31, 1978 commitments for loans up to $70,000,000 and $55,000,000 were available to Genesco and GFC, respectively, under revolving credit agreements expiring April 10, 1979 with 13 U.S. banks and one Canadian bank. Interest is payable quarterly at ½ of 1% above the Corporate Base Rate effective at the First National Bank of Chicago plus a commitment fee of ½ of 1% on the daily unused portion of the commitment. Compensating balance arrangements provide that the Company will endeavor to maintain collected funds on deposit in each bank which, over a calendar year, average 10% of the bank's commitment plus 10% of the average borrowings under the commitment.

Genesco's revolving credit agreement requires mandatory prepayments on borrowings in an amount equal to 100% of the net cash proceeds from any sales of assets, liquidations or other dispositions of certain operations. The banks' commitment will be reduced by the amount of any such prepayments.

Genesco's revolving credit agreement requires the Company to maintain working capital of at least $100,000,000, a current ratio of not less than 1.5 to 1 and Tangible Net Worth of at least $65,000,000 plus any increases or decreases (decreases may not exceed $1,500,000) in Tangible Net Worth from adjustments to the provision for operations being divested, sale of operations, or extraordinary (excluding credits for income taxes) or nonrecurring transactions. GFC's agreement requires it, among other things, to maintain an Effective Net Worth (stockholder's equity plus subordinated debt) of at least $36,000,000 and a ratio of debt (excluding subordinated debt) to Effective Net Worth of not more than 4 to 1 and the sum of cash and net receivables equal to at least 108% of total liabilities. At July 31, 1978 all of these requirements were met.

A $2,500,000 line of credit with a European bank is available to Genesco provided total borrowings do not exceed total commitments under the revolving credit agreement. The line can be withdrawn at any time at the bank's option. Borrowings are usually for sixty or ninety day periods at interest rates based on the Eurodollar interbank rate. No minimum deposit is required at any time.

At July 31, 1978, Genesco had short-term loans outstanding of $59,350,000 under its revolving credit agreement and $2,500,000 under the line of credit at an average interest rate of 9.48%. GFC had short-term loans outstanding of $34,000,000 under its revolving credit agreement at an interest rate of 9.50%. During the year borrowings by Genesco and GFC averaged $99,063,000 at a weighted average interest rate of 8.33%. The maximum borrowings at any month end were $119,850,000. At July 31, 1978, unused commitments amounted to $8,150,000 and $21,000,000 for Genesco and GFC, respectively.

Note 10 Long-Term Debt

	1978	1977
4.75% convertible subordinated note due 1982 with annual payments of $25,000; convertible into common stock at $24.94 per share	**$ 350,000**	$ 375,000
5.00% notes due 1984 with annual payments of $2,000,000	**24,000,000**	26,000,000
5.25% notes due 1981 with annual payments of $938,000	**6,864,000**	7,803,000
10.375% senior sinking fund notes due December 1984 with annual payment of $4,900,000	**60,200,000**	65,100,000
6.50% convertible subordinated debentures (series A) due 1987; convertible into common stock at $41.67 per share	**1,172,000**	1,172,000
6.50% convertible subordinated debentures (series B) due 1987; convertible into common stock at $45.45 per share	**4,244,000**	4,244,000
Notes payable incurred by companies prior to acquisition due in varying amounts to 1984 at various interest rates from 4% to 7%	**1,271,000**	2,005,000
Total long-term debt	**98,101,000**	106,699,000
Unamortized debt discount	**(227,000)**	(276,000)
Total long-term debt and unamortized debt discount	**97,874,000**	106,423,000
Current portion	**(8,447,000)**	(8,596,000)
Totals	**$89,427,000**	$ 97,827,000

The Company guarantees all payments on long-term convertible debentures of $12,383,000 of Genesco World Apparel, Ltd., a nonconsolidated foreign finance subsidiary. The guarantee is subordinated to the prior payment in full of all present and future senior indebtedness.

Amendments to certain of the Company's loan agreements reduced the percentage of Consolidated Net Current Assets to Consolidated Funded Indebtedness the Company is required to maintain from 150% to 110% through July 30, 1979 and to 130% through July 30, 1980. At July 31, 1978 the Company's Consolidated Net Current Assets were 128% of Consolidated Funded Indebtedness.

See Note 12 "Stockholders' Equity— Restrictions on Dividends and Redemptions of Capital Stock."

Note 11 Capitalized Lease Obligations

Future minimum lease payments under leases capitalized at July 31, 1978, together with the present value of the minimum lease payments follow:

Year ending July 31:	
1979	$ 11,711,000
1980	8,923,000
1981	7,719,000
1982	6,412,000
1983	3,388,000
Later years	29,722,000
Total minimum payments	67,875,000
Amount representing interest	(22,572,000)
Present value of minimum payments	45,303,000
Current portion	(8,068,000)
Total	$ 37,235,000

Note 12
Stockholders' Equity

Distinguishing characteristics of capital stock

Class (1)	Shares Authorized	Issued at July 31: Shares 1978	Shares 1977	Amount in thousands 1978	Amount in thousands 1977	Common Convertible Ratio	No. of Votes
$4.50 Cumulative Convertible Preferred	82,368	16,955	16,955	$ 1,696	$ 1,696	3.75	*
Subordinated Cumulative Convertible Preference							
$4.25 Series A	68,943	600	600	60	60	—	3
$6.00 Series B	161,981	121,144	121,144	12,114	12,114	2.40(2)	2
$6.00 Series C	269,291	125,813	125,652	12,582	12,565	2.20(2)	2
Subordinated Serial Preferred (Cumulative)							
$2.30 Series 1	131,826	89,319	89,319	3,608	3,644	.83	1
$3.18 Series 2	395,626	165,436	165,436	8,768	8,437	—	1
$4.75 Series 3	105,875	80,058	80,058	8,006	8,006	2.11	2
$4.75 Series 4	103,000	65,648	65,648	6,565	6,565	1.52	1
$4.75 Series 5	122,500	98,474	98,474	9,847	9,847	1.61	1
$1.50 Subordinated Cumulative Preferred	5,000,000	105	105	3	3	—	1
Employees' Subordinated Convertible Preferred	5,000,000	1,239,318	1,291,726	37,180	38,752	1.00(3)	1
Total Preferred Stock				100,429	101,689		
Common Stock ($1 Par Value)	20,000,000	13,100,059	13,030,145	13,100	13,030	—	1

(1) Each class is listed in descending order of preference in liquidation except that Series 1 and 2 Preferred Stock rank equally in liquidation.
(2) Also exchangeable for $100 principal amount of 6.50% Convertible Subordinated Debentures. At July 31, 1978 such exchanges were prohibited.
(3) Also convertible into one share of Subordinated Cumulative Preferred Stock.
* The $4.50 Preferred Stock normally has no voting rights; however, as long as the Company is in arrears with respect to mandatory redemption requirements or is four quarters in arrears with respect to the payment of dividends, holders of such stock have the right to elect two persons to the Board of Directors. Such right was exercised at the Annual Meeting held February 8, 1978.

Cumulative Convertible Preferred Stock:

Stated and liquidation values—$100 per share; redemption price—$101.50 per share. The Company is required to redeem 998 shares each December 31 at $100 per share. Such redemption with respect to 1977 was not made and is in arrears ($99,800).

Subordinated Cumulative Convertible Preference Stock:

Stated and liquidation values and redemption price for each series—$100 per share. The Company is required to offer to redeem on each December 31 and June 30, respectively, pro rata from holders of Series B and Series C, 5% of the shares of such stock originally issued. The Company may, at its option and on a cumulative basis, credit against such redemption requirement shares which have been converted into Common Stock or purchased or otherwise redeemed and not previously credited. At July 31, 1978, sufficient shares had been converted, purchased or otherwise redeemed to satisfy the redemption requirements until 1979 and 1983, respectively.

Subordinated Serial Preferred Stock:

Stated and liquidation values and redemption price for Series 1 and 2—$40.40 and $53.00, respectively. Stated and liquidation values for Series 3, 4 and 5—$100 per share. Redemption price for Series 3 and 5—$101 per share; for Series 4—$103 per share. At July 31, 1978, the Company was in arrears with respect to mandatory redemptions of Series 2 in the amount of $8,768,000.

Provisions of Series 5 require the Company to offer, during each November of 1975-1978, to redeem on each succeeding December 31, 20% of the shares (approximately $2,500,000) of Series 5 originally issued. Offers with respect to 1975-1977 were not made and are in arrears ($7,350,000).

Subordinated Cumulative Preferred:

Stated and liquidation values and redemption price—$30 per share.

Employees' Subordinated Convertible Preferred:

Stated and liquidation value—$30 per share. Shares are not redeemable.

Common Stock:

Common shares reserved at July 31, 1978 for conversion of senior securities and for employee stock plans amounted to 2,527,297 and 751,841, respectively.

Restrictions on Dividends and Redemptions of Capital Stock

Payment of preferred dividends was suspended by the Board of Directors in March 1975. The Tennessee General Corporation Act prohibits the payment of dividends by a corporation when it has no surplus as defined by the Act. The Company does not currently have any such surplus.

The Company is also prohibited by its revolving credit agreement from paying dividends on and redeeming shares of any class of stock except preferred stock in aggregate annual amounts not exceeding $200,000.

The Company is currently restricted by certain of its long-term debt instruments from paying dividends on and redeeming shares of any class of stock, except fixed dividends on and mandatory redemptions of shares of $4.50 Preferred Stock in aggregate annual amounts not exceeding $200,000. The most stringent of such restrictions at this time will not permit dividends or redemptions unless immediately thereafter Consolidated Net Tangible Assets are at least 275% of Consolidated Funded Indebtedness. At July 31, 1978, the Company was $67,718,000 short of this requirement. In addition, preferred dividends of $11,910,000 and mandatory redemptions of $16,218,000 were in arrears. Therefore, Consolidated Net Tangible Assets were $95,846,000 less than would have been required in order to pay the dividend and redemption arrearages at July 31, 1978.

The Company's debt instruments also contain other restrictions on dividends and redemptions which at July 31, 1978 were not as restrictive; however, certain of such restrictions would also have prohibited dividends and redemptions.

Note 12 Stockholders' Equity, (continued)

Dividend arrearages

Class of Stock	Date Dividends Paid to	Arrearage at July 31, 1978 Per Share	Arrearage at July 31, 1978 Aggregate
$4.50 Cumulative	October 31, 1976	$ 7.88	$ 134,000
$4.25 Series A	January 31, 1975	14.88	9,000
$6.00 Series B	January 31, 1975	21.00	2,535,000
$6.00 Series C	January 31, 1975	21.00	2,612,000
$2.30 Series 1	January 31, 1975	8.05	719,000
$3.06 Series 2	January 31, 1975	11.13	1,841,000
$4.75 Series 3	January 31, 1975	16.62	1,331,000
$4.75 Series 4	January 31, 1975	16.62	1,091,000
$4.75 Series 5	January 31, 1975	16.62	1,637,000
$1.50 Subordinated	January 31, 1975	5.25	1,000
Total			$11,910,000

Changes in the shares of the Company's capital stock

	Common		Preferred	
	Issued	Treasury	Employees'	Other
Issued at July 31, 1976	12,982,576	482,165	1,339,278	764,402
Redemptions	—0—	—0—	—0—	(998)
Return of escrowed shares	—0—	1,525	—0—	—0—
Conversion of securities	47,569	—0—	(47,552)	(13)
Issued at July 31, 1977	13,030,145	483,690	1,291,726	763,391
Return of escrowed shares	—0—	3,173	—0—	—0—
Issuances	17,500	—0—	—0—	164
Conversion of securities	52,414	—0—	(52,408)	(3)
	13,100,059	486,863	1,239,318	763,552
Less treasury stock	486,863	—0—	301,677	1,860
Outstanding at July 31, 1978	12,613,196	486,863	937,641	761,692

Note 13 Income Taxes

Income tax expense is composed of the following:

	1978	1977
Current taxes:		
Canadian	**$ 3,800,000**	$ 3,416,000
State	**343,000**	226,000
U.S. Federal	**5,874,000**	—0—
U.S. Federal future tax benefits written off*	**—0—**	41,645,000
Total income taxes	**10,017,000**	45,287,000
Extraordinary credit—U.S. Federal	**(5,874,000)**	—0—
Total Income Tax Expense	**$ 4,143,000**	$45,287,000

*As a result of 1977 operating losses and the decision to divest certain operations.

The effective tax rate on pretax earnings was 51.7% in 1978. The items creating the difference between this effective rate and the 48% Federal statutory rate are:

Provision for taxes at 48%	$ 9,295,000
Tax effect of intercompany dividend from Canada eliminated in consolidated financial statements	1,232,000
Tax credit of nonconsolidated subsidiaries included in consolidated U.S. Federal income tax return	(748,000)
Variation between Canadian and U.S. tax rate	(450,000)
Foreign taxes paid on dividends and royalties	491,000
Miscellaneous	197,000
Total Income Taxes	$10,017,000

The Company's tax returns have been examined by the Internal Revenue Service through 1974 and all differences settled through 1972. Adjustments proposed for 1973 and 1974 have not been accepted by the Company at this time since the deductibility of net operating loss carryforwards affected by the adjustments cannot be settled until audits of the years in which the carryforwards offset taxable income are completed. After giving effect to the proposed adjustments, the Company will have net operating loss carryforwards available to offset future taxable income as follows:

Expiration Date	Amount
July 31, 1979	$15,550,000
July 31, 1980	36,848,000
July 31, 1984	10,785,000
July 31, 1985	19,563,000
Total Net Operating Loss Carryforwards	$82,746,000

In addition, the Company has recorded for financial statement purposes expenses amounting to $69,861,000 which will be deductible for Federal income tax purposes in future years. These include depreciation, sale and leaseback transactions, profits on installment sales, deductions related to accounts receivable as well as provisions made for divestments and retail store closings.

Note 14 Rentals and Lease Commitments

For purposes of the following disclosure, a distinction has been made between noncapitalized "financing" leases and "other" leases. A "financing" lease is a lease with a term covering 75% or more of the estimated useful life of the property or with lease payments sufficient for the lessor to recover its investment plus interest.

Rental expense of ongoing operations for the two years ended July 31 was as follows:

	1978	1977
Financing leases:		
Minimum rentals	**$ 8,516,000**	$ 7,591,000
Contingent rentals	**550,000**	484,000
Sublease rentals	**(466,000)**	(19,000)
Total financing leases	**8,600,000**	8,056,000
Other leases:		
Minimum rentals	**28,150,000**	24,407,000
Contingent rentals	**3,810,000**	3,140,000
Sublease rentals	**(631,000)**	(3,000)
Total other leases	**31,329,000**	27,544,000
Total Ongoing Operations	**$39,929,000**	$35,600,000

Rental expense for 1977 of operations to be divested or discontinued was $11,399,000.

Note 14 Rentals and Lease Commitments (continued)

Minimum rental commitments payable in future periods under noncancellable long-term leases (reduced by sublease rentals) are as follows:

Fiscal Year	Financing Leases	Other Leases	Total
Ongoing operations:			
1979	$ 7,240,000	$ 21,970,000	$ 29,210,000
1980	6,981,000	19,579,000	26,560,000
1981	6,687,000	15,484,000	22,171,000
1982	6,531,000	11,477,000	18,008,000
1983	6,225,000	10,122,000	16,347,000
1984-1988	28,521,000	39,569,000	68,090,000
1989-1993	7,733,000	23,981,000	31,714,000
1994-1998	592,000	7,130,000	7,722,000
After 1998	899,000	2,824,000	3,723,000
Total ongoing operations	71,409,000	152,136,000	223,545,000
Operations to be divested or discontinued	19,294,000	22,719,000	42,013,000
Totals	$90,703,000	$174,855,000	$265,558,000

In addition to minimum rentals, some leases provide for the Company to pay real estate taxes and other expenses and, in certain cases, additional rentals based on sales. Renewal options exist for most long-term leases.

The present values of minimum lease commitments under noncapitalized financing leases at July 31 are as follows:

	1978	1977
Ongoing operations:		
Retail real property	**$53,058,000**	$57,172,000
Wholesale & manufacturing real property	**3,409,000**	2,972,000
Other property	**761,000**	966,000
Total present value of minimum lease commitments	**57,228,000**	61,110,000
Present value of sublease rentals	**(534,000)**	(1,477,000)
Total ongoing operations	**56,694,000**	59,633,000
Operations to be divested or discontinued	**12,236,000**	17,519,000
Totals	**$68,930,000**	$77,152,000

The range and weighted average interest rates used in the computation of the above present values are as follows:

	Range	Average
Retail real property	2.0-10.6%	5.2%
Wholesale & manufacturing real property	1.2- 9.7%	5.0%
Other	5.0- 5.5%	5.1%
Present value of sublease rentals	2.0-10.6%	7.6%

If financing leases were capitalized, the effect on net earnings would be less than 1%.

In fiscal 1979 the Company will be required to retroactively capitalize, in accordance with Statement of Financial Accounting Standards No. 13 (SFAS No. 13) certain leases entered into prior to January 1, 1977, unless to do so would result in a probable violation of an existing loan agreement. If such leases had been accounted for as capital leases at July 31, 1978 and 1977, the Company's net earnings for 1978 would have increased by $54,000 and its net loss for 1977 would have been increased by $105,000. The effect on its balance sheet at such dates would have been as follows:

	1978	1977
Increase in assets	**$36,834,000**	$39,722,000
Increase in liabilities	**50,324,000**	53,365,000
Decrease in stockholders' equity	**13,490,000**	13,643,000

The above includes amounts applicable to leases with Tennessee Ravenwood Properties, Inc. (Ravenwood), a real estate company owned by the Genesco Retirement Trust. On August 28, 1978, the Company agreed to purchase Ravenwood, the effect of which would be to increase the Company's assets and liabilities by an additional $4,455,000. If SFAS No. 13 is not adopted, the acquisition of Ravenwood would increase the Company's assets and liabilities by $13,453,000.

Note 15 Retirement Plans

Pension expense relating to continuing operations amounted to $5,412,000 in 1978 and $4,922,000 in 1977, including amortization of prior service cost over 30 years. At the latest valuation date, actuarially computed vested benefits exceeded the total pension fund and the balance sheet accrual at July 31, 1978 by $23,406,000 and the unfunded actuarial liability was $37,216,000.

Effective April 1, 1978, the Board of Directors approved a change to the Genesco Retirement Plan which increased the minimum benefit payable to participants. The figures above include the effect of this change as follows: 1978 pension expense increased $417,000 ($1,250,000 annually); vested benefits in excess of the pension fund increased $6,736,000 and the unfunded actuarial liability increased $5,748,000.

Note 16 Employee Stock Plans

The stockholders of the Company have approved four stock purchase or option plans enabling employees to purchase shares of common or employees' preferred stock. These are the Savings Fund-Employee Stock Purchase Plan, the Key Executives Stock Option Plan and Employees Incentive Plans A and B.

Employees have been granted options to purchase shares of common stock under the Savings Fund-Employee Stock Purchase Plan at a price to be determined on August 31, 1978, subject to a minimum price of $10.01 determined at date of grant. Options to purchase 23,341 shares of common stock were outstanding on July 31, 1978 and expire August 31, 1978. 1,136,164 additional shares are available for future options.

The Company has 728,500 shares of common stock authorized to be sold upon exercise of nonqualified stock options granted to key executive employees under the Key Executive Stock Option Plan. Options may not be granted at a price less than market value on the date of grant. Options granted under this plan become exercisable at the rate of 25% per year beginning one year from date of grant and expire 10 years from date of grant. At July 31, 1978, options granted in December 1975 to purchase 176,500 shares at $5.125 per share were outstanding.

Under Employee Incentive Stock Plan A, payments on stock purchase accounts are made by payroll deductions and, upon resumption of the common stock dividend, will also be made by the Company through compensatory payments. Payments under Employee Incentive Stock Plan B are similar except employees make only limited payments and then only in specified circumstances. Employee stock purchase accounts under both plans amounted to $18,946,000 at July 31, 1978 and $19,396,000 at July 31, 1977 and were secured by 896,276 employees' preferred shares and 32,655 common shares at July 31, 1978. No further sales of shares under plans A and B are contemplated.

Note 17 Pending Legal Proceedings

The Company and certain other retailers are defendants in a number of treble damage actions brought on behalf of various charge account customers of the defendants. These actions allege that defendants fixed retail prices of women's clothing in various cities in violation of the antitrust laws.

The Company is a defendant in a class action charging it with publishing false and misleading financial statements and reports and, as a result, inflating the price of the Company's common stock. The complaint seeks damages in an unspecified amount. The Court has limited the class to common stockholders who purchased their stock between August 21, 1972 and August 27, 1973 and who held such stock as of the latter date.

The Company, GFC and certain former employees of the Company are defendants in a class action against them, a former customer of the Company and others. The suit alleges violations of the Federal securities laws and that the Company and GFC were "controlling persons" of the former customer now in bankruptcy and are thereby liable for its actions.

The Company is the defendant in an action brought by the former owners of a business acquired by the Company in 1968 in exchange for shares of the Company's common stock. The complaint alleges that the price of the Company's common stock was inflated as a result of false and misleading financial statements and reports issued by the Company and seeks rescission of the exchange and damages of approximately $10,000,000.

The Company is a defendant in three separate actions brought by owners of Series B and Series C preference stock, two of which are class actions on behalf of the holders of each of the respective Series and name certain directors as defendants. All of the suits allege that the Company improperly suspended the right to exchange such stock for 6½% convertible subordinated debentures and that the indenture provisions permitting such suspension were improperly included in the indenture. The complaints seek damages or an injunction requiring the Company to reinstate the exchange privilege. The third such action against the Company, brought by certain holders of Series B stock who elected to exclude themselves from the class action, contains additional allegations that the Company published false and misleading financial statements and reports upon which such stockholders relied in deferring the exercise of their exchange privilege. The Company is also a defendant in an action brought by certain holders of Series 2 preferred stock alleging that the Company wrongfully refused to make sinking fund deposits aggregating $8,768,000. The complaint seeks an order requiring such deposits to be made and directing the Company to pay accrued and unpaid dividends and to redeem such stock or, alternatively, that compensatory damages be awarded. The Company believes it has meritorious defenses to such actions. If the Company were required by the Courts either to reinstate the exchange privilege relating to the Series B and Series C preference stock, or to make sinking fund deposits, redemptions or dividend payments with respect to the Series 2 preferred stock, lenders under certain of the Company's debt instruments might assert that such action constituted an event of default which, in turn, could result in acceleration of the maturity of substantially all of the Company's outstanding indebtedness.

The Company has been named a defendant in various other actions which, in the opinion of management, involve claims of lesser significance.

Management of the Company is unable to predict the outcome or to estimate with any degree of certainty any potential loss which may result from the above-described litigation.

Note 18 Business Segment Information

Sales to unaffiliated customers, operating income (loss), identifiable assets and intersegment sales of the Company's business segments for the two years ended July 31, 1978 are included in the 5 year "Business Segment Information" table on page 8. Intersegment sales are made at prices comparable to sales to unaffiliated customers.

Depreciation and amortization of and additions to plant, equipment and capitalized lease rights for the two years ended July 31 were:

	1978	1977
Depreciation and amortization:		
Footwear	**$ 6,020,000**	$ 5,867,000
Men's apparel	**2,629,000**	2,614,000
Specialty retailing	**3,099,000**	2,950,000
Variety retailing	**1,974,000**	2,120,000
Corporate	**1,309,000**	2,026,000
Total ongoing operations	**15,031,000**	15,577,000
Operations to be divested	**—0—**	2,268,000
Totals	**$15,031,000**	$17,845,000
Additions to plant, equipment and capitalized lease rights:		
Footwear	**$ 8,074,000**	$ 6,220,000
Men's apparel	**2,723,000**	1,862,000
Specialty retailing	**3,910,000**	6,637,000
Variety retailing	**601,000**	572,000
Corporate	**2,416,000**	867,000
Operations being divested	**—0—**	1,233,000
Totals	**$17,724,000**	$17,391,000

Note 19 Quarterly Financial Information (Unaudited)

In Thousands	3 Months October	3 Months January	3 Months April	3 Months July	Fiscal Year
Net sales					
1978	$260,654	$280,003	$243,493	$ 264,201	$1,048,351
1977	259,097	276,093	245,138	234,459	1,014,787
Gross margin					
1978	85,256	94,592	77,407	85,356	342,611
1977	83,760	88,285	72,350	77,307	321,702
Operating income (loss): Ongoing operations					
1978	7,979	12,147	835	(1,597)	19,364
1977	6,170	3,586	(358)	(4,252)	5,146
Operations to be divested					
1978	—0—	—0—	—0—	—0—	—0—
1977	62	(2,151)	(2,042)	(2,832)	(6,963)
Earnings (loss) before extraordinary credit					
1978	4,262	6,023	(323)	(900)	9,062
1977	2,215	(1,405)	(13,125)	(123,468)	(135,783)
Net earnings (loss)					
1978	$ 7,395	$ 10,080	$ (323)	$ (2,216)	$ 14,936
1977	2,215	(1,405)	(13,125)	(123,468)	(135,783)
Primary earnings (loss) per common share: Before extraordinary credit					
1978	$.27	$ .40	$ (.09)	$ (.14)	$ .44
1977	.11	(.18)	(1.11)	(9.94)	(11.12)
Net earnings (loss)					
1978	.52	.72	(.10)	(.24)	.90
1977	.11	(.18)	(1.11)	(9.94)	(11.12)

Note 20 Current Replacement Cost Information (Unaudited)

The Company has estimated the current replacement cost of inventories and productive capacity (generally plant, equipment and capitalized lease rights excluding land and construction in process) as of July 31, 1978 and July 31, 1977 and the approximate effect such replacement cost would have had on cost of sales and depreciation expense for the years then ended. The Company has not estimated replacement cost on operations being divested.

The Company believes the replacement cost for inventories is approximately the same as historical cost; however, replacement cost of sales, cost of productive capacity and related depreciation are higher than historical costs. Replacement cost information is based on assumptions and estimates that have limitations due to the subjective nature of the estimating process. Since the methods used do have limitations and are experimental, this information should be viewed with a degree of caution and not viewed as being indicative of future financial results of the Company.

Statistical replacement cost information will be contained in the Company's annual report to the Securities and Exchange Commission on Form 10-K.

Securities Information—Preferred Stock

All classes of the Company's preferred stock are traded in the over-the-counter market. All preferred dividends are fourteen quarters in arrears except the $4.50 Cumulative Convertible Preferred which is seven quarters in arrears. The following table shows the bid and asked prices for each quarter of fiscal 1978 and 1977 on those classes of preferred which were quoted. All remaining classes were virtually untraded and no meaningful price information could be obtained.

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	Bid	Asked	Bid	Asked	Bid	Asked	Bid	Asked
$4.50 Cumulative								
1978	49/47	—	45/43	50/47	—	47	NQ	NQ
1977	NQ	NQ	42	—	48/47	—	48/47	—
$6.00 Series B								
1978	30	35	26	30	26	—	NQ	NQ
1977	32	—	38½/32	42	38½	—	NQ	—
$6.00 Series C								
1978	30	35	26	36/30	26	—	NQ	NQ
1977	33	38	38½/33	42	38½	—	NQ	NQ
$2.30 Series 1								
1978	15/13	18/16	12	15	NQ	NQ	NQ	NQ
1977	12	15	17/14	18	18½	20½	NQ	NQ
$3.18 Series 2								
1978	18/12	—	13	—	NQ	NQ	NQ	NQ
1977	10	—	15/11	—	14/13	—	13/12	—

Information for this chart furnished by the National Quotation Bureau. Where two numbers are shown they are the high and low for the period.

Securities Information—Common Stock

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	High	Low	High	Low	High	Low	High	Low
1978	4⅝	3⅜	5⅝	3½	8⅛	5⅛	7½	5½
1977	6⅞	5	5⅞	4⅞	6¾	4½	6½	4

Years ended July 31	1978	1977	1976	1975	1974
Net sales	**$1,048,351**	1,014,787	1,061,390	1,014,798	1,056,772
Cost of sales	**$ 705,740**	693,085	686,394	679,080	701,291
Gross margin	**$ 342,611**	321,702	374,996	335,718	355,481
Selling, general and administrative expenses	**$ 302,960**	304,500	316,132	306,817	304,055
Interest expense	**$ 21,286**	18,646	17,787	24,951	22,351
Other income (loss)	**$ 999**	(373)	174	1,729	1,322
Operating income (loss):					
Ongoing operations	**$ 19,364**	5,146	41,438	8,955	30,637
Operations to be divested	**$ —0—**	(6,963)	(187)	(3,276)	(240)
Provision for divestments and retail store closings	**$ —0—**	(33,224)	—0—	—0—	—0—
Income taxes	**$ 10,017**	45,287	20,510	3,804	14,096
Minority interests	**$ —0—**	—0—	—0—	—0—	204
Nonconsolidated companies	**$ (285)**	(262)	(1,186)	(6,943)	(2,017)
Earnings (loss) before discontinued operations and extraordinary credit	**$ 9,062**	(80,590)	19,555	(5,068)	14,080
Earnings (loss) from discontinued operations	**$ —0—**	(55,193)	(3,625)	(9,359)	3,379
Earnings (loss) before extraordinary credit	**$ 9,062**	(135,783)	15,930	(14,427)	17,459
Extraordinary credit—U.S. federal income tax	**$ 5,874**	—0—	—0—	—0—	—0—
Net earnings (loss)	**$ 14,936**	(135,783)	15,930	(14,427)	17,459
Primary earnings (loss) per common share:					
Before discontinued operations and extraordinary credit	**$ .44**	(6.71)	1.28	(.68)	.83
Before extraordinary credit	**$ .44**	(11.12)	1.00	(1.42)	1.09
Net earnings (loss)	**$ .90**	(11.12)	1.00	(1.42)	1.09

All figures are in thousands except amounts per share.

Net Sales
Sales for 1978 reflect only a three percent increase over 1977 primarily because of the divestment program approved in August 1977 (see Note 2 on page 14). Sales of ongoing operations increased eight percent due principally to increases in unit sales of men's branded footwear, tailored clothing and slacks. These increases reflect consumer acceptance of the Company's branded products. Specialty and variety retailing sales increased only three percent due to the closing of unprofitable stores. The table on page 8 sets forth comparative sales information in more detail.

The reduction in sales for fiscal 1977 compared to fiscal 1976 was due to a decline in consumer spending and the divestment of two women's footwear retailing operations in the last quarter of fiscal 1976.

Gross Margin
The improvement in gross margin in fiscal 1978 reflects the effect of increased wholesale and retail sales as well as increased wholesale margins due primarily to increased emphasis on branded goods in the men's apparel segment. Foreign currency translation losses reduced gross margin by $4,328,000 in 1978 compared to $2,295,000 in 1977.

The reduction in fiscal 1977 compared to fiscal 1976 is attributed to markdowns of finished goods inventory in excess of normal levels due to reduced sales volume and underabsorption of overhead due to reduced levels of production. It was further reduced by a roll-back of earnings by the Canadian Anti-inflation Board and by a government ordered recall of children's sleepwear treated with Tris (a flame retardant chemical).

Selling, General and Administrative Expenses
Operating expenses decreased slightly in 1978 compared to 1977 due primarily to the inclusion in 1977 of expenses amounting to $16,806,000 relating to operations being divested (see "Net Sales" above). Foreign currency translation reduced operating expenses $2,293,000 in fiscal 1978 compared to $403,000 in 1977.

The decrease in expenses in fiscal 1977 compared to 1976 was due principally to the reduction in wholesale sales and the divestment of two women's retailing operations in the last quarter of fiscal 1976.

Interest Expense
Interest expense increased 14% in fiscal 1978 over fiscal 1977 due to an increase of 24% in average short-term interest rates. Average short-term debt decreased three percent in fiscal 1978; however, long-term debt of GFC increased $30 million in December 1976. Funds from borrowings by GFC are used to purchase customer obligations from Genesco.

The increase in interest expense for fiscal 1977 compared to fiscal 1976 is principally due to higher interest rates on borrowings of long-term debt by Genesco and Genesco Financial Corporation which replaced existing indebtedness.

Income Taxes
The decrease in the tax provision for fiscal 1978 compared to fiscal 1977 is primarily due to a write-off at the end of fiscal 1977 of net operating loss carryforward benefits of U.S. operations. (See Note 13 "Income Taxes.") Income taxes were adjusted in the 4th quarter of 1978 by $857,000 as a result of a reduction in the Canadian tax provision made during the first three quarters.

Nonconsolidated Companies
The reduction in losses of nonconsolidated companies in fiscal 1977 compared to fiscal 1976 is due to the retirement in 1976 of debt of a nonconsolidated subsidiary and to liquidation of an unprofitable nonconsolidated subsidiary in fiscal 1976.

Genesco Board of Directors

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*Director Emeritus

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Nashville, Tennessee 37237
Morgan Guaranty Trust Company
New York, New York 10004

Registrars
Common Stock and Preferred Stock
Chemical Bank
New York, New York 10015
Third National Bank
Nashville, Tennessee 37244

Independent Accountants
Price Waterhouse & Co.
Nashville, Tennessee 37219

New York Stock Exchange Symbol
GCO

Annual Stockholders Meeting
Monday, December 4, 1978

Form 10-K
Each year Genesco files with the Securities and Exchange Commission a Form 10-K report which contains more detailed information. If you would like to receive a copy, please send your request to Director-Consolidated Financial Reporting, Genesco Inc., Route K-41, P. O. Box 941, Nashville, Tennessee 37202

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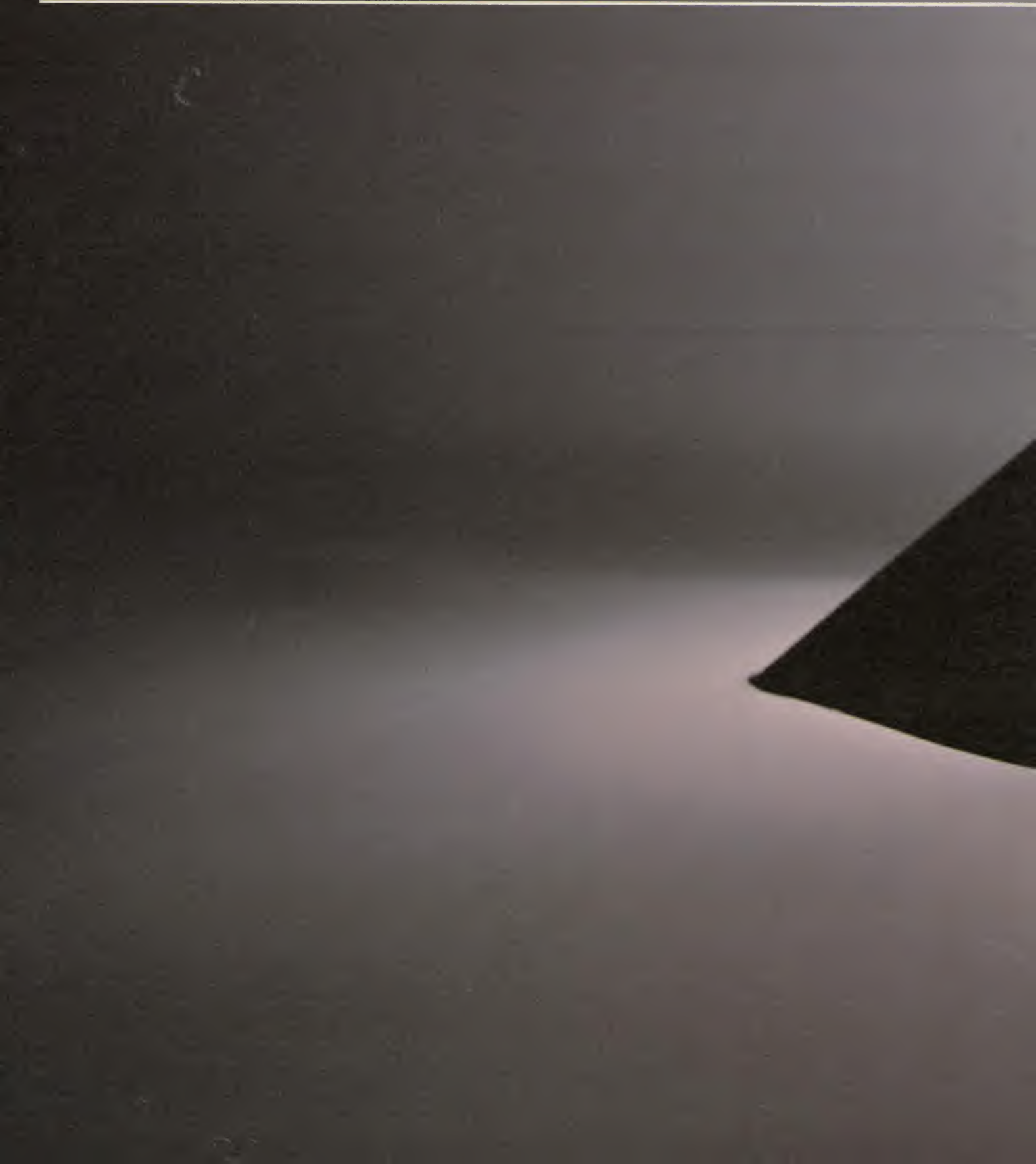
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